

STATE OF CALIFORNIA
Budget Change Proposal - Cover Sheet
DF-46 (REV 03/13)

Fiscal Year 2013-14	BCP No. 1	Org. Code 0860	Department Board of Equalization	Priority No. 1
Program Sales and Use Tax			Element All	Component N/A

Proposal Title
ASSEMBLY BILL 93 AND SENATE BILL 90, MANUFACTURER'S SALES AND USE TAX EXEMPTION

Proposal Summary
The Board of Equalization (BOE) requests \$421,000 (\$275,000 General Fund (GF), \$146,000 Reimbursements) and 1.4 positions in FY 2013-14, \$824,000 (\$538,000 GF, \$286,000 Reimbursements) and 6.6 positions in 2014-15, and \$787,000 (\$514,000 GF, \$273,000 Reimbursements) and 6.6 positions in 2015-16 and ongoing to administer AB 93 (Chapter 69, Statutes of 2013, July 11, 2013) and SB 90 (Chapter 70, Statutes of 2013, July 11, 2013), which provides for a new partial sales and use tax exemption for sales of tangible personal property to specified taxpayers.

Requires Legislation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Code Section(s) to be Added/Amended/Repealed		
Does this BCP contain information technology (IT) components? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <i>If yes, departmental Chief Information Officer must sign.</i>	Department CIO		Date
For IT requests, specify the date a Special Project Report (SPR) or Feasibility Study Report (FSR) was approved by the California Technology Agency, or previously by the Department of Finance. <input type="checkbox"/> FSR <input type="checkbox"/> SPR Project No. Date:			

If proposal affects another department, does other department concur with proposal? ☐ Yes ☐ No
Attach comments of affected department, signed and dated by the department director or designee.

Budget Officer	Date	Chief, Financial Management Division	Date
Deputy Director, Administration	Date	Executive Director	Date

Department of Finance Use Only

Additional Review: ☐ Capital Outlay ☐ ITCU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐ Technology Agency

BCP Type: ☐ Policy ☐ Workload Budget per Government Code 13308.05

PPBA Date submitted to the Legislature

STATE BOARD OF EQUALIZATION
Sales and Use Tax Program
Manufacturers Partial Exemption
Fiscal Year 2013-14

A. Proposal Summary

The Board of Equalization (BOE) requests \$421,000 (\$275,000 General Fund (GF), \$146,000 Reimbursements) and 1.4 positions in FY 2013-14, \$824,000 (\$538,000 GF, \$286,000 Reimbursements) and 6.6 positions in 2014-15, and \$787,000 (\$514,000 GF, \$273,000 Reimbursements) and 6.6 positions in 2015-16 and ongoing to administer AB 93 (Chapter 69, Statutes of 2013, July 11, 2013) and SB 90 (Chapter 70, Statutes of 2013, July 11, 2013), which provides for a new partial sales and use tax exemption for sales of tangible personal property to specified taxpayers.

B. Background/History

The BOE has administered the Sales and Use Tax Law since its inception in 1933. Over the years, various exemptions have been added to the law. Historically, a sale of tangible personal property has either been subject to tax or exempt from tax. However, with the passage of Senate Bill 671 in 1993, the Legislature created the first partial tax exemption. Partial exemptions were created so the state may provide an economic benefit to a certain type of transaction or industry in the form of a tax exemption while not infringing upon the sales and use tax revenue that would go to a local government. Since 1993, other partial tax exemptions have been added to the Sales and Use Tax Law.

The first partial tax exemption was also an exemption for manufacturing equipment. That partial tax exemption became operative January 1, 1994 and contained a sunset provision and ceased to be operative January 1, 2004. The new partial tax exemption added by AB 93 and SB 90 is similar to the prior partial exemption in that the exemption may only apply to qualifying property sold to a qualified person. However, there are significant differences between the old and new partial exemption. First, the definition of a qualified person has been expanded to include businesses in additional North American Industry Classification System (NAICS) codes. Second, the partial exemption is no longer limited to a new trade or business as was required previously, but instead contains an annual cap on the amount a taxpayer may claim. These two differences increase the number of taxpayers that may be able to take advantage of this partial exemption compared to the original partial exemption for manufacturing equipment. Finally, the partial exemption rate is different than what was provided for previously.

C. State Level Considerations

The BOE collects taxes and fees that provide approximately 34 percent of the annual revenue for state government and essential funding for counties, cities, and special districts. In fiscal year 2010-11, the BOE-administered taxes and fees produced \$53.7 billion for education, public safety, transportation, housing, health services, social services, and natural resource management. The BOE administers the state's sales and use, fuel, alcohol, tobacco, and other taxes and collects fees that fund specific state programs. More than one million businesses are registered with the agency.

Passage of AB 93 (Chaptered 69, Statutes of 2013, July 11, 2013) and SB 90 (Chaptered 70, Statutes of 2013, July 11, 2013) provides for a new partial sales and use tax exemption to be administered by the BOE. Funding is needed to ensure the continued collection and proper allocation of the sales and use tax.

D. Justification

The BOE administers the sales tax for the state, local jurisdictions, and special tax jurisdictions. The BOE is charged with making sure taxpayers properly register for a seller's permit and timely report the sales and use taxes due. One of the components that significantly complicates administration of the sales and use tax is the inclusion of a partial tax exemption.

Typically, when a sale of tangible personal property is exempt from the tax, the retailer does not need to collect sales tax reimbursement from the customer or report tax to the BOE on the transaction. Instead,

the taxpayer obtains documentation, if necessary, to support the exemption and reports the sale as exempt on the sales and use tax return.

On a taxable transaction, the taxpayer may collect sales tax reimbursement from the customer and reports the taxable transaction to the BOE and pays the tax. The taxpayer does not need any supporting documentation from the customer as the transaction is not subject to an exemption.

With a partial tax exemption, the taxpayer generally collects sales tax reimbursement from the customer on the portion of the transaction that is not exempt and also must obtain supporting documentation for the exemption. Current law provides for several partial tax exemptions that are somewhat limited in the number of taxpayers they may apply to.

The new partial exemption provided by AB 93 and SB 90 will apply to an estimated 68,000 existing taxpayers. Additionally, the partial exemption is at a different rate from all other partial exemptions currently administered by the BOE. The current sales and use tax rate applicable to the sale or purchase of any tangible personal property not subject to a partial exemption is 7.50 percent, plus any applicable district taxes. Most partial exemptions currently administered by the BOE are taxed at a rate of 2.0 percent, plus any applicable district taxes. Sales of gasoline are also subject to a partial exemption and are taxed at a rate of 2.25 percent, plus any applicable district tax. This new partial exemption will provide that sales of qualifying property sold to a qualified person be taxed at a rate of 3.3125 percent, plus any applicable district taxes. Due to the complex nature of the new partial exemption and the different tax rate applicable to this partial exemption, it is anticipated that taxpayers will make errors in claiming and reporting the partial tax exemption. It is also anticipated that call volume to the BOE's Customer Service Center due to this new partial exemption will increase by over 20,000 calls in the first year.

The new partial tax exemption will apply to purchases made on or after July 1, 2014. However, the BOE will require additional resources prior to this date to perform necessary programming changes and system testing to ensure taxpayers will be able to properly claim the partial tax exemption. Additionally, the BOE will need to prepare and distribute materials to taxpayers regarding the new partial exemption prior to the date the new partial exemption becomes effective. Staff also plans to participate in education and outreach efforts prior to the operative date of the new partial exemption. All of these efforts prior to the operative date are crucial to ensure the BOE is able to properly administer this new partial exemption and taxpayers have all of the necessary resources to properly claim the new partial exemption.

The new manufacturing partial exemption is an exceptionally complicated exemption. The partial exemption only applies to qualifying property sold to a qualified person. The statute also includes numerous definitions to determine what property may qualify and who it may be sold to. Due to the complexity of the new partial exemption, the BOE will receive additional claims for refund, petitions for redetermination, and inquiries from taxpayers and district staff regarding the proper application of the partial exemption. The BOE will require additional resources to properly administer this new partial exemption.

E. Outcomes and Accountability

Projected Outcomes

Workload Measure	2014-15	2015-16
Estimated revenue loss for exemptions claimed	\$637 million	\$681 million

Staff examined data available for taxpayers that fall within the specified NAICS codes for industries identified in AB 93 and SB 90 to determine the amount of sales that may qualify for the partial exemption. Estimated expenditures are as follows:

Capital Expenditures - California
(in billions)

	FY 2014-15	FY 2015-16
Manufacturing	\$13.87	\$14.83
Biotechnology	\$0.65	\$0.70
Physical, Engineering & Life Science	\$0.69	\$0.73
	<u>\$15.21</u>	<u>\$16.26</u>

The estimated annual revenue loss from exempting from the 4.1875 percent sales and use tax for qualifying purchases used in manufacturing (NAICS 31-33), biotechnology R&D (NAICS 541711) and physical, engineering & life sciences R&D (NAICS 541712) amounts to \$637 million in FY 2014-15 and \$681 million in FY 2015-16 and ongoing.

F. Analysis of All Feasible Alternatives

Alternative 1 – Provide funding of \$421,000 and 1.4 positions in FY 2013-14 and \$824,000 and 6.6 positions in FY 2014-15 and ongoing.

Pros:

- Provides the resources needed to timely and efficiently administer the statutorily imposed partial tax exemption
- Provides the resources needed to perform necessary outreach to taxpayers so they are aware of the proper application of the partial exemption
- Provides the resources needed to answer taxpayer inquiries regarding the complex partial exemption
- Allows the state to realize the full economic benefit of the stimulus provided by this new partial tax exemption

Cons:

- Requires a budget augmentation

Alternative 2 – Do not approve this request

Pros:

- Does not require a budget augmentation

Cons:

- Does not provide the BOE with the necessary resources to timely and efficiently administer the statutorily imposed partial tax exemption
- The State may not fully realize the economic benefits intended by this stimulus bill

G. Implementation Plan

October 2013 and ongoing

- Hire and train staff
- Perform necessary IRIS, mid-tier and web application updates
- Notify taxpayers of new partial tax exemption

- Answer taxpayer inquiries
- Process incoming tax returns with new partial exemption
- Process claims for refunds
- Follow up on leads and perform routine audits
- Issue deficiency and refund determinations
- Process petitions for redetermination

H. Supplemental Information *(Check box(es) below and provide additional descriptions.)*

☒ None ☐ Facility/Capital Costs ☐ Equipment ☐ Contracts ☐ Other _____

I. Recommendation

Alternative 1 is recommended.

This alternative allows the BOE to meet its statutory obligation to efficiently administer the partial tax exemption.

SALES AND USE TAX DEPARTMENT (SUTD)**Audit Determination and Refund Section****2.0 Business Taxes Specialist I (BTS I)**

Workload Detail				
Classification: BTS I	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Evaluate and research claims for refund associated with the new partial tax exemption	H	8	400	3,200
Correspond with taxpayers and representatives and how it relates to claims filed and payments made	H	.5	800	400
Total BTS I hours				3,600
Total BTS I Positions Requested (1,800 Hours/Position)				2.0

Due to the imposition of this complicated partial exemption, it is anticipated the BOE will receive claims for refund associated with the new partial exemption. Any claims for refund associated with a partial exemption for manufacturing equipment are likely to involve complex issues as the partial exemption has several requirements that must be met in order for the partial exemption to apply. Timely processing of these claims for refund will require additional resources.

The BTS I evaluates and researches claims for refund with respect to the new partial tax exemption. The BTS I is responsible for communicating by both phone and written correspondence with taxpayers and their representatives in relation to the claims filed and payments of the taxes/fees paid.

Petitions Section**1.0 Business Taxes Specialist II (BTS II)**

Workload Detail				
Classification: BTS II	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Prepare summary analysis of petition cases	H	8	200	1,600
Create and update IRIS records	H	.5	200	100
Confer with taxpayers and their representatives	H	1	100	100
Total BTS II hours				1,800
Total BTS II Positions Requested (1,800 Hours/Position)				1.0

The Petitions Section is responsible for managing the BOE's statewide appeal (petition) process for the SUTD. This includes the initial creation and acknowledgment of new petitions, the creation and maintenance of the IRIS case record, audits of Consumer Use Tax petitioned cases, SUTD representation at appeals conferences, review and analysis of each petitioned case in relation to laws, rules, and/or policies.

The BTS II is responsible for reviewing petitions for redetermination and preparing a summary analysis for submission to the Appeals Section for conference and creation and maintenance of the IRIS case record. BTS II staff also confers with taxpayers and their representatives to gather additional information regarding the petition case. Due to the complex nature of the manufacturer partial exemption, there will be an increase in petition cases that are overly complex and will require staff at the BTS II level.

Audit and Information Section**1.0 Associate Tax Auditor (ATA)**

Workload Detail				
Classification: ATA	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Responding to telephone inquiries	H	1	660	660
Responding to written inquiries	H	8	144	1,152
Total ATA hours				1,812
Total ATA Positions Requested (1,800 Hours/Position)				1.0

When taxpayers or consumers require guidance regarding the proper application of tax to complex issues, these inquiries are handled by staff in the Audit and Information Section. The complex nature of the new partial tax exemption will result in a significant increase in both written and telephone inquiries received from taxpayers and consumers. Therefore, additional resources will be necessary to provide the necessary guidance.

1.0 Business Taxes Specialist I (BTS I)

Workload Detail				
Classification: BTS I	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Responding to inquiries from taxpayers	H	8	105	840
Responding to inquiries from district staff	H	24	40	960
Total BTS I hours				1,800
Total BTS I Positions Requested (1,800 Hours/Position)				1.0

When taxpayers or district staff require guidance regarding the proper application of tax to complex issues, these inquiries are handled by staff in the Audit and Information Section. The complex nature of the new partial tax exemption will result in a significant increase in both written and telephone inquiries received from taxpayers and district staff. Therefore, additional resources will be necessary to provide the necessary guidance.

TECHNOLOGY SERVICES DEPARTMENT (TSD)**0.5 Staff Information Systems Analyst (SISA)**

Workload Detail				
Classification: Staff Information System Analyst	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Maintenance request analysis	H	20	18	360
System test design planning	H	30	12	360
System test and documentation	H	15	12	180
Total SISA hours				900
Total SISA Positions Requested (1,800 Hours/Position)				0.5

The SISA System Analyst/Tester performs system testing and user system testing for computer system changes. Due to the partial exemption at a different rate than other partial exemptions, additional staff support for testing will be necessary. Additionally, anticipated sales and use tax rate changes in the future

(such as the sunset of Proposition 30 on January 1, 2017) will impact the partial exemption calculation on the return, requiring ongoing system maintenance and testing.

EXTERNAL AFFAIRS DEPARTMENT

Taxpayer Information Section (TIS)

2.0 Tax Technician III (TT III)

Workload Detail				
Classification: TT III	Time Measure		On-going Activities	
Activity	M=Minutes H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
Answer taxpayer and public inquiries received on the BOE toll free 800 phone number concerning the new partial exemption	M	10	21,600	3,600
Total TT III hours				3,600
Total TT III Positions Requested (1,800 Hours/Position)				2.0

Due to the imposition of this complicated partial exemption, TIS estimates an additional 21,600 phone calls in the first year and 10,800 phone calls annually and ongoing from taxpayers and consumers. In order to handle the increase in call volumes, the TIS requests two TT III positions. One of the positions is a 1-year limited-term position to handle increased call volume in FY 2014-15, while the other is a permanent position to handle ongoing call volume. The TT III's provide answers to general questions, guidance to the BOE resources, and refer callers to the appropriate sections and units.

DF-46 (REV 03/13)

Fiscal Summary

(Dollars in thousands)

BCP No. 1	Proposal Title MANUFACTURER'S SALES AND USE TAX EXEMPTION			Program SUTD		
Personal Services		Positions			Dollars	
	CY	BY	BY+1	CY	BY	BY+1
Total Salaries and Wages ¹	1.4	6.6	6.6	\$86	\$433	\$439
Total Staff Benefits ²				\$39	\$183	\$198
Distributed Administration						
Total Personal Services	1.4	6.6	6.6	\$125	\$616	\$637
Operating Expenses and Equipment						
General Expense				\$46	\$69	\$32
Distributed Administration						
Printing				\$29		
Communications				\$9	\$24	\$6
Postage				\$45		
Travel-In State						
Travel-Out of State						
Training				\$2	\$6	\$6
Facilities Operations				\$34	\$79	\$79
Utilities				\$1	\$1	\$1
Consulting & Professional Services: Interdepartmental ³						
Consulting & Professional Services: External ³				\$113		
Data Center Services				\$8	\$18	\$18
Information Technology				\$9	\$11	\$8
Equipment ³						
Other/Special Items of Expense:						
Total Operating Expenses and Equipment				\$296	\$208	\$150
Total State Operations Expenditures				\$421	\$824	\$787
Fund Source	Item Number					
	Org	Ref	Fund			
General Fund	0860	001	0001	\$275	\$538	\$514
Special Funds ⁵						
Federal Funds						
Other Funds (Specify)						
Reimbursements	0860	001	0995	\$146	\$286	\$273
Total Local Assistance Expenditures						
Fund Source	Item Number					
	Org	Ref	Fund			
General Fund						
Special Funds ⁵						
Federal Funds						
Other Funds (Specify)						
Reimbursements						
Grand Total, State Operations and Local Assistance				\$421	\$824	\$787

¹ Itemize positions by classification on the Personal Services Detail worksheet.² Provide benefit detail on the Personal Services Detail worksheet.³ Provide list on the Supplemental Information worksheet.⁴ Other/Special Items of Expense must be listed individually. Refer to the Uniform Codes Manual for a list of standard titles.⁵ Attach a Fund Condition Statement that reflects special fund or bond fund expenditures (or revenue) as proposed.

Personal Services Detail

(Whole dollars)

BCP No. 1	Proposal Title MANUFACTURER'S SALES AND USE TAX EXEMPTION
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Salaries and Wages Detail

Classification ^{1 2}	Positions			Salary Range	Dollars		
	CY	BY	BY+1		CY	BY	BY+1
TSD					\$0	\$0	\$0
Staff Information Systems Analyst (Spec.) a/	0.4	0.5	0.5	\$70,356	\$28,142	\$35,178	\$35,178
					\$0	\$0	\$0
External Affairs					\$0	\$0	\$0
Tax Technician III b/	0.3	1.0	1.0	\$39,888	\$11,966	\$39,888	\$39,888
Tax Technician III c/		1.0		\$39,888	\$0	\$39,888	\$0
					\$0	\$0	\$0
SUTD					\$0	\$0	\$0
Business Taxes Specialist I d/	0.0	2.0	2.0	\$71,988	\$0	\$143,976	\$143,976
Business Taxes Specialist I e/	0.5	1.0	1.0	\$71,988	\$35,994	\$71,988	\$71,988
Associate Tax Auditor d/		1.0	1.0	\$64,164	\$0	\$64,164	\$64,164
Business Taxes Specialist II f/			1.0	\$77,400	\$0	\$0	\$77,400
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
					\$0	\$0	\$0
Blanket Funds:							
Overtime					0	35,781	3,628
Temporary Help	0.2	0.1	0.1		10,379	2,412	2,412
Total Salaries and Wages ³	1.4	6.6	6.6		\$86,481	\$433,275	\$438,634

Staff Benefits Detail	CY	BY	BY + 1
OASDI	6,616	33,146	33,556
Health/Dental/Vision Insurance	13,741	63,158	69,118
Retirement	17,731	81,498	89,189
Miscellaneous			
Workers' Compensation	787	3,617	3,959
Industrial Disability Leave	83	382	418
Non-Industrial Disability Leave	35	163	178
Unemployment Insurance	69	318	348
Other:	259	1,192	1,305
Total Staff Benefits ³	\$39,321	\$183,474	\$198,071
Grand Total, Personal Services	\$125,802	\$616,749	\$636,705

¹ Use standard abbreviations per the Salaries and Wages Supplement. Show any effective date or limited-term expiration date in parentheses if the position is not proposed for a full year or is not permanent, e.g. (exp 6-30-13) or (eff 1-1-13)

Note: Information provided should appear in the same format as it would on the Changes in Authorized Positions.

² If multiple programs require positions, please include a subheading under the classification section to identify positions by

³ Totals must be rounded to the nearest thousand dollars before posting to the Fiscal Summary.

a/ Permanent position starting 10-1-13

b/ Permanent position starting 4-1-14

c/ One-year limited term position starting 7-1-14

d/ Permanent position(s) starting 7-1-14

e/ Permanent position starting 1-1-14

f/ Permanent position starting 7-1-15